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ISRAEL'S REQUESTS FOR MILITARY AND ECONOMIC ASSISTANCE

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Analysis of U.S. Assistance Options

I. THE PROBLEM WE FACE

A. Israeli Requests

Israel has requested substantial assistance from the United States during the next five years in the form of military equipment, technological aid and foreign exchange. Specifically, the Israelis would like:

-- Jet aircraft. Israel has requested the sale of 25 F-4 Phantom and 100 A-4 Skyhawk aircraft (a total of approximately \$270 million), with delivery to start in 1971.

-- Other military equipment. The current Israeli requests, the magnitude of their proposed arms imports during 1970-1974, and the European reluctance to sell major military items, all indicate the Israelis will request considerable military equipment from the U.S. during the next five years. Specifically, they will probably attempt to purchase additional Hawk surface-to-air missiles, tanks, armored personnel carriers, helicopters, and electronic and communications equipment.

-- Capital goods imports. Israel would like to reduce reliance on foreign arms suppliers by achieving a substantial degree of domestic self-sufficiency in arms production. Based on Israeli economic forecasts, they apparently plan to import a substantial amount of capital goods, raw materials and component parts required for production of military equipment. In addition, Israel is requesting production rights and licenses to manufacture a variety of U.S. military equipment.

-- Financial aid. Finally, Israel forecasts a shortfall in foreign exchange of \$1.2 billion during 1970-74 and has asked for financial assistance from the United States to close the gap. This aid would be used to meet forecasted import requirements and increase the level of foreign exchange reserves. Israel claims that no additional financial aid will be required after 1974.

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B. Significance of the Requests

The current Israeli requests, if approved, would have a significant impact on the nature and the course of U.S. assistance policy in the Near East. Specifically, the Israelis have indicated a desire for:

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-- More U.S. equipment. The principal difference between the current and previous requests is not primarily in the type of equipment, but rather in the magnitude of the requests. The Israelis have come to rely almost exclusively on the U.S. for modern arms and equipment.

-- Production rights. The magnitude of the Israeli requests suggests they will attempt to develop a substantial domestic production capability, largely based on licenses to produce U.S. military equipment. The size of this military-industrial complex suggests the Israelis will attempt to develop self-sufficiency in most major military items by 1974.

-- Multi-year commitment. The Israeli requests strongly suggest they seek a multi-year commitment from the U.S. to support Israeli policy in the Near East. Previous U.S. policy has been decided on a case-by-case basis with no future implications.

C. Key Issues for Decisions

1. What Israeli military strategy, if any, should the U.S. support?

The current Israeli strategy is to maintain the capability to absorb a well-coordinated attack by all Arab nations and inflict defeat on them within a short period. The U.S. must decide whether or not to support this Israeli strategy or a less ambitious alternative.

2. What Israeli economic development strategy, if any, should the U.S. support?

The Israeli economic development strategy is aimed at maintaining a full capacity growth rate of 8% without inflation while developing the domestic production capability to be largely self-sufficient in military equipment. The U.S. must decide whether or not to support this Israeli development strategy of rapid growth and growing military self-sufficiency.

3. If the U.S. decides to support some Israeli military and economic strategy, what level of U.S. assistance is appropriate?

To carry out their military and economic strategies, the Israelis will request large amounts of military equipment, production rights, and \$1.2 billion in foreign exchange assistance over the next five years. The U.S. must decide how to respond to these requests. If the U.S. decides to support some Israeli strategy, we must also decide what level of U.S. assistance is appropriate.

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4. If the U.S. decides to provide some level of assistance to Israel during 1970-74, what is the appropriate mix of military and economic assistance programs?

In providing assistance to the Israelis, the U.S. has to choose among a wide variety of programs -- from military credit to debt rollover -- which would help to meet Israeli needs.

5. If the U.S. decides to permit a wide range of Israeli military procurement in the U.S., what policy guidelines and means for enforcing them are necessary?

Because of Israel's intensive effort to develop domestic military production, they will probably request export licenses or production rights to a variety of U.S. equipment, some of which relate to fairly sensitive equipment. Appropriate policy guidelines should be established to monitor these programs.

II. CURRENT MILITARY FORCES IN THE NEAR EAST

Force Comparisons. Israel's four principal Arab enemies (Egypt, Syria, Jordan and Iraq) ^{1/} are numerically superior to Israel in every category of military equipment. As shown on Page 3A, the Arabs outnumber Israel six to one in army personnel, three to one in jet fighter aircraft and artillery, and seven to one in anti-aircraft artillery. The current Arab/Israeli force ratios, however, are not appreciably different from those just prior to the June 1967 war.

Capability Comparisons. In spite of the numerical advantage of the principal Arab nations, Israel retains undisputed military superiority, both on the ground and in the air. Factors contributing to this Israeli superiority are:

1. Israeli Air Capability. Although outnumbered six to one in supersonic aircraft and three to one overall, the Israelis maintain absolute air superiority.

-- Many Arab aircraft are not assigned to operational units and others are not flyable because of poor maintenance and repair capabilities. Consequently, only about half of the Arab aircraft are operationally ready at any given time, compared to 85% of Israeli aircraft. Considering only operational aircraft, the Arab numerical superiority today is reduced to 3.6:1 for high performance aircraft, 1.1:1 for medium performance aircraft and 1.8:1 overall.

^{1/} Throughout this paper Egypt, Syria, Jordan and Iraq are referred to as the principal Arab nations. References to all Arab nations include these four plus Saudi Arabia, Lebanon and Algeria.

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ARAB/ISRAELI FORCE COMPARISON

	<u>JUNE '67</u>			<u>NOVEMBER '69</u>		
	<u>Arabs^{1/}</u>	<u>Israelis</u>	<u>Ratio</u>	<u>Arabs^{1/}</u>	<u>Israelis</u>	<u>Ratio</u>
Army Personnel (000) ^{2/}	366	55	6.7:1	376	65	5.8:1
Tanks	2519	1123	2.2:1	3121	1215	2.6:1
Personnel Carriers (APC)	2383	2000	1.2:1	2475	2000	1.2:1
Artillery	3055	877	3.5:1	3175	1016	3.1:1
AAA	2686	534	5.0:1	3507	534	6.6:1
Fighter Aircraft						
High performance	280	65	4.3:1	386	62	6.2:1
Medium performance	289	140	2.1:1	295	162	1.8:1
Total	569	205	2.8:1	681	224	3.0:1

1 / UAR, Syria, Jordan, Iraq.

2 / Approximately 20% of the Arab forces would be needed for internal security missions and thus not available to fight. On the other hand, Israel can mobilize up to 300,000 personnel in one week.

Source: DIA.

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-- In terms of combat sorties, the Israelis have several times more capability than the Arabs. Sortie rates are determined principally by the number of qualified pilots per aircraft and the available technical and maintenance capability. Israel has a substantial advantage in both categories. Current estimates of Israeli capability indicate that on the first day of a war, Israel could fly approximately 1600 combat sorties compared to 900 for the four Arab countries (a favorable Israeli ratio of almost two to one). During the first week, Israel could average 1000 sorties per day compared to 200 per day for the Arabs (five to one).

-- Israel's advantage is even larger in terms of ordnance delivery capability. Based on U.S. estimates, the Israelis could deliver about 5200 tons of air ordnance on the first day compared to 1150 tons for the Arabs (five to one). During the first week of fighting, Israel could deliver 2900 tons per day compared to 300 tons per day for the Arabs (ten to one).

-- In addition to those quantifiable factors, the Israeli air force has some distinct qualitative advantages over the Arabs. Israel has approximately 450 combat qualified pilots (about two per aircraft) while the Arab nations have only 375 (one for every two aircraft) not all of whom are qualified to fly combat missions. Long flying hours, excellent training, and years of actual combat experience have made Israeli pilots among the best in the world. On the other hand, Arab pilots are poorly trained and lack the experience and self-confidence of the Israelis. In air to air combat, the Arab/Israeli loss ratio is approximately fifty to one. The overall combat loss ratio (to all causes) is five to one.

2. Israeli Ground Force Capability. Numerical comparisons of Arab/Israeli ground forces also understate Israel's military capability.

-- Although outnumbered six to one in active duty army personnel, Israel could mobilize to a total of 310,000 well-trained troops within one week. On the other hand, the Arabs have only limited mobilization capability and could probably field a force of approximately 400,000 troops in an emergency (compared to 366,000 at present). Moreover, many of the Arab conscripts would likely be poorly trained and motivated.

-- The Arabs have a three to one numerical advantage in field artillery. However, the Arab artillery is highly vulnerable to Israeli air strikes in an offensive role and would be of little advantage unless Israel lost air superiority. Although outnumbered seven to one in AAA, the Israelis believe their present AAA, Hawk missiles and interceptor aircraft provide an effective air defense system.

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-- The principal factor restricting the size of the Arab forces is the limited supply of personnel that are physically and mentally qualified to operate modern military equipment. The major Israeli constraint is the quantity, rather than the quality, of available manpower.

3. Arab Coordination. The degree of coordination and cooperation assumed to exist between the principal Arab forces is the key factor affecting Israeli force requirements. Poor coordination was a principal cause of the Arab failure in 1967 when the Israelis fought and defeated one Arab nation at a time. Since that time, the principal Arab nations have formed a Supreme Command to coordinate operations and separate commands to control the Eastern and Western fronts. However, there is no evidence of effective coordination to date, and the Arab nations continue to regard each other with distrust. The Arabs are concerned with defense of their own frontiers and will probably depend solely on their own resources in the next confrontation.

III. ALTERNATIVE ISRAELI FORCE POSTURES

Introduction

The military forces desired by Israel will be determined by (1) Israeli military objectives and (2) the size and capability of the Arab forces. Different Israeli strategies and Arab capabilities would require military forces of different sizes and compositions. At the same time, the capability the Arabs try to build is integrally related to Israeli military capability. This interrelationship leads to the cycle of action and reaction that has characterized the Arab/Israeli arms race since the mid-1950s.

This paper estimates Israeli force requirements under different assumptions about Israel's military strategy and the speed of the Near East arms escalation. While any set of finite alternatives ignores the dynamic nature of the arms race, it does not mean the action/reaction cycle will disappear. It clearly will not. However, the alternative strategies available to the Israelis and the Arab responses selected in this analysis establish a range within which the arms race will probably fluctuate.

One note of caution. The analysis estimates the nature and the magnitude of the military aid Israel will probably require from external sources to implement each alternative strategy. The estimates assume that, given the current international environment, the United States will be the sole supplier of major military equipment to Israel.

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To the extent that this assumption is wrong, the U.S. arms sales needed to implement each strategy should be reduced accordingly. For example, if the French released their embargo on Israel's fifty Mirage 5 aircraft, the requirement for U.S. supersonic aircraft would be substantially reduced.

Alternative Israeli Strategies

Israeli force requirements have been developed to support three alternative military strategies:

1. Current Israeli Strategy is (a) to maintain the ability to absorb an Arab attack and then defeat any combination of forces from all the Arab nations within three weeks, 1/ and (b) to demonstrate the ability to retaliate against Arab raids, guerrilla actions, and sabotage so severely as to end them.

2. Alternative Strategy #1 is to maintain sufficient military capability to defeat, within three weeks, a coordinated attack by Syria, Jordan, Iraq and the UAR.

3. Alternative Strategy #2 is to maintain sufficient military capability to defeat, within three weeks, an attack by the UAR followed by uncoordinated attacks from Jordan, Syria and Iraq.

Several important definitions and qualifications should be remembered in analyzing these alternative Israeli strategies:

-- First, the Current Israeli Strategy represents our best approximation of Israel's present military strategy based on existing capabilities, arms requests, and recent military statements. It does not necessarily reflect the strategic concepts of Israel's defense planners.

-- Second, Alternative Strategies #1 and #2 represent slightly less ambitious levels of Israeli military capability developed for use in this analysis.

-- Third, these alternative strategies do not preclude the Israelis from adopting one that is entirely unrelated. However, the actual Israeli strategy will probably fall within the range defined by these three strategies.

1/ A three week period was chosen for illustrative purposes and to indicate that Israel plans to fight a short war. Israeli and Arab military supplies, POL, and ammunition could not sustain a full-scale war for longer than 3-4 weeks.

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-- Fourth, the strategies do not necessarily indicate what the Israelis will actually do under different circumstances; they merely define the range of what they could do if they so desired. The strategies establish broad limits of capability, not intentions.

Within any strategy the Israelis would have sufficient military capability to accomplish a variety of military objectives. For example, under the Current Israeli Strategy, they could (a) defeat a coordinated Arab attack, (b) launch preemptive attacks on any Arab nation and (c) punish Arab guerrilla operations through attacks on key cities or installations.

Alternative Arab Responses

Two possible Arab responses to each alternative Israeli strategy have been defined as follows:

1. Alternative Response #1 is to improve the quality and operational capability of the Arab forces by providing training and replacement equipment without increasing current force levels.

2. Alternative Response #2 is to increase force levels as rapidly as Arab manpower, technical and training capabilities would permit and as rapidly as would be militarily useful.

These alternative Arab responses should be viewed in light of the following limitations:

-- They represent two arbitrary responses selected from an infinite number of possible Arab (and Soviet) alternatives. They do, however, approximate meaningful upper and lower bounds of Arab activity.

-- The response desired by the Arabs may not be supported by the Soviet Union or other potential arms suppliers.

-- The Arab response will be influenced significantly by the strategy the Israelis choose to pursue.

Alternative Israeli Force Structures

Enclosure II shows a detailed set of forces required in 1974 for each alternative Israeli strategy and Arab response.

--- Forces under the Current Israeli Strategy represent our best estimate of what the Israelis believe they will need to implement their strategy. They are based primarily on current force

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levels, requests already submitted and estimates of future requests. The estimates have not been coordinated with Israeli defense planners.

-- Forces shown for each of the two alternative Israeli strategies represent U.S. estimates of the forces required to implement the strategy. Unlike the Current Strategy, the forces do not represent what we believe the Israelis would request; they are U.S. projections of what they would need to implement each strategy.

-- The forces shown are illustrative only. They are not the only forces that could successfully implement each strategy. They do, however, represent reasonable estimates of the forces required under alternative Israeli strategies and Arab responses.

1. Aircraft Requirements. Israeli aircraft requirements have been estimated on the basis of alternative Arab inventories, historical performance factors, and estimates of future capabilities. Arab/Israeli aircraft ratios used in the analysis are shown below. On the basis of current ratios, the Israelis have unquestioned air superiority. However, Arab capability is expected to improve by 1975 as aircraft operational rates increase (from 50% to 60%), pilot quality improves due to training and combat experience, and sortie rates increase as a result of better maintenance and technical personnel. On the other hand, Israeli air capability should also increase as pilot and maintenance quality improve and if additional U.S. F-4 and A-4 aircraft are added to the inventory. The Arab/Israeli aircraft ratios shown below should be sufficient to carry out the alternative Israeli strategies.

	<u>Current Ratio</u>	<u>Current Israeli Strategy</u>	<u>Alternative Strategy #1</u>	<u>Alternative Strategy #2</u>
High Performance	6.2:1	4.0:1	5.0:1	6.0:1
Medium Performance	1.8:1	1.2:1	1.7:1	2.0:1
Total	3.0:1	2.4:1	3.3:1	3.9:1

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Israeli requirements for procurement of foreign jet aircraft under each alternative strategy and Arab response are shown below. These estimates include aircraft needed for force expansion, attrition and obsolescence (see Enclosures III and IV).

ISRAELI REQUIREMENTS FOR U.S. AIRCRAFT 1/

	<u>Number of U.S. Aircraft</u>	
	<u>Arab Response #1</u>	<u>Arab Response #2</u>
Current Strategy	NA <u>2/</u>	175
Alternative Strategy #1	19	83
Alternative Strategy #2	2	40

1/ Aircraft required in addition to currently scheduled deliveries.

2/ Not applicable. The current Israeli strategy assumes increased Arab force levels.

2. Tanks. The Arab countries could not effectively utilize many more tanks than they have at present. However, the Israelis have already indicated a desire to purchase 250 M-60 tanks over the next few years. They probably contemplate a force increase of up to 100 additional tanks, and the remaining 150 would be used to modernize existing forces on a one-for-one basis. No increase in tank forces would be required under the alternative strategies, but replacement and modernization would require approximately 100 tanks during 1970-74.

3. Armored Personnel Carriers (APCs). There is some indication the Israelis would like to increase their overall ground mobility by increasing their APC forces from 2000 at present to approximately 6000 by 1974. The two alternative Israeli strategies would not require additional APCs, but modernization and attrition would require about 2000 APCs during 1970-74.

4. Hawk Missiles. The Israelis will probably request an additional Hawk battalion (18 launchers and 160 missiles). This equipment would probably also be necessary under the highest Arab response (Response #2) for each alternative Israeli strategy.

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5. Helicopters. Israel is thought to be interested in purchasing additional U.S. transport helicopters. They are also anxious to develop a helicopter gunship capability. No additional helicopters are required under either of the alternative Israeli strategies.

The following table summarizes the dollar value of Israeli import requirements under each alternative strategy and Arab response (see Enclosure V).

TOTAL ISRAELI ARMS IMPORTS REQUIREMENTS
(1970-1974)

	<u>Total Value (\$ Millions)</u>	
	<u>Arab Response #1</u>	<u>Arab Response #2</u>
Current Strategy	NA	1030
Alternative Strategy #1	280	520
Alternative Strategy #2	200	390

Impact of Alternative Strategies

1. Israeli Military Capability

-- The Current Israeli Strategy provides convincing deterrence of a full-scale Arab attack. Israel would have sufficient military capability to defeat any combination of Arab states and maintain air superiority at least through 1974. Israel could, at will, attack any principal Arab nation with a punitive strike. Israel would be able to sustain the present, or increased, levels of retaliatory raids indefinitely.

-- Alternative Israeli Strategy #1 provides convincing deterrence to a coordinated attack by Syria, Jordan, Iraq and the UAR. Israeli air superiority is retained through 1974, and Israel could probably sustain the current conflict for the foreseeable future. The principal differences between the Current Strategy and Alternative #1 are that: (a) Alternative #1 assumes the worst possible case would involve a coordinated attack by four (not seven) Arab nations; and (b) the Current Strategy is based on Israeli perceptions while Alternative #1 represents the U.S. assessment of military requirements.

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-- Alternative Israeli Strategy #2 provides the capability to defeat attacks by the UAR followed by uncoordinated attacks from Syria, Jordan and Iraq. Alternative #2 would not provide air or ground superiority against a well-coordinated full-scale attack by all four Arab nations, thus raising the possibility of Arab miscalculation. However, to the extent that the Arab nations are unable (or unwilling) to form an effective alliance, Alternative Strategy #2 would provide convincing deterrence to an attack by any one Arab nation.

2. Need for U.S. Intervention

-- The Current Israeli Strategy should preclude the need for U.S. military intervention on behalf of Israel through 1974. In the event of substantial third-country (e.g., Soviet) manned assistance to the Arabs (probably aircraft, pilots, and naval forces), the U.S. might be required to supply manned air and naval forces to prevent an Israeli defeat.

-- Alternative Strategy #1 should also eliminate the need for U.S. intervention (except in response to substantial outside assistance) at least through 1974.

-- Alternative Strategy #2 would not require U.S. intervention unless (a) the UAR and one or more Arab countries execute a well-coordinated and successful attack, and/or (b) there is substantial external manned assistance to the Arabs.

3. Cost to the United States. Assuming the United States remains the sole supplier of major military end items to Israel between 1970 and 1974:

-- The Current Israeli Strategy would require sales of approximately \$1 billion of U.S. arms and equipment.

-- Alternative Strategy #1 would require U.S. arms sales of about \$280 million under Arab Response #1 and \$520 million under Arab Response #2.

-- Alternative Strategy #2 would require arms sales of about \$200 million and \$390 million respectively under each of the alternative Arab responses.

4. Israeli Independence from U.S.

As explained fully in a later section, the magnitude of the Israeli economic request strongly indicates that they will attempt to develop military independence from the U.S. They have significantly increased their requests for domestic production licenses and are likely to begin development of major military end items during 1970-74. This program would provide a substantial degree of military self-sufficiency.

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IV. ISRAELI ECONOMIC SITUATIONPrevious U.S. Assistance to Israel

During 1948-1969, the U.S. provided \$1.5 billion in economic and military assistance to Israel. About 80% of the total aid was in the form of economic grants and loans. Enclosure VI shows U.S. economic and military assistance, by year, since 1965.

	<u>\$ Millions</u>	<u>Percent</u>
Economic Aid		
Grants	278.0	18
Loans	235.2	16
P.L. 480	426.8	28
Eximbank Loans	297.0	20
Total Economic Aid	1237.0	82
Military Credit Assistance	278.9	18
Total Aid	1515.9	100

Several important points emerge from a review of U.S. military and economic assistance to Israel.

-- U.S. economic assistance to Israel has increased since 1967, although credit terms have hardened. In the three years prior to the war, the U.S. supplied an average of \$44 million in economic assistance. Since 1967, U.S. economic assistance has averaged \$64 million per year with about half in agricultural commodity assistance (P.L. 480) and half in long-term loans from the Export-Import Bank.

-- U.S. military credit assistance has also increased since 1967. Since the June 1967 war, credit sales have averaged \$55 million annually.

Current Israeli Economic Requests

Israel has forecasted a foreign exchange shortfall of \$1.2 billion during 1970-74. The shortfall is projected to increase gradually from \$200 million in 1970 to \$300 million in 1973. The following is known about the Israeli requests.

-- Military Credit Assistance. Israel has requested \$149 million for military credit assistance in 1970 including \$30 million already agreed as credit on the sale of fifty F-4 aircraft plus the

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\$119 million outstanding balance remaining to be paid on the same sale. Israel also wants better credit terms and a two-year moratorium on repayments. The 100 A-4 and 25 F-4 aircraft in the current Israeli request would cost about \$270 million, for most of which Israel will want credit.

-- AID Assistance. Israel has requested \$50 million from AID in FY 1970 to support its foreign exchange requirements.

-- Agricultural Commodities Assistance. Israel has requested a total of \$54 million in agricultural commodity assistance (P.L. 480) during CY 1970 (compared to \$37 million in CY 69).

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-- Debt Roll-over. While Israel has not officially proposed a debt roll-over, it has been maintained informally. If insufficient financial aid is available, Israel will probably request such action.

-- Additional Resources. In addition, the U.S. has several other alternatives including concession of additional El Al landing rights, science cooperation, and textile quotas.

Israeli Balance of Payments Forecast

The analysis of Israel's economic requests is less precise than analysis of its military requirements, mainly because the Israeli economic requests have been couched in very general terms. The following analysis, therefore, is an attempt, with the help of some simple economic models CIA has developed, to determine what the Israelis are asking us to do.

The shortcomings in this analysis suggest that an important next step before the U.S. commits itself on the total Israeli request may be to arrange more detailed financial discussions with the Israelis. This need not, of course, rule out progress on some more immediate needs that could be met with conventional U.S. programs.

Israel's projected financial requirements during 1970-74 are based on the Israeli balance of payments forecast shown in Enclosure VII. All forecasts of balance of payments needs are highly sensitive to assumptions about growth rates, imports, exports, capital movements, and investment levels. The key assumptions underlying the Israeli estimate of financial assistance are discussed below.

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1. Gross National Product (GNP) is assumed to grow at an annual rate of approximately 8% per year, the highest sustainable growth rate without unacceptable inflation. It provides for continuous increases in per capita income during the period. Small changes in this growth rate would have an appreciable impact on foreign exchange requirements. For instance, assuming a 6% growth rate -- which would involve slightly higher unemployment rates and lower consumption increases -- the projected balance of payments deficit would decline from \$900 million to \$500 million.

2. Exports are forecast to grow at an annual rate of about 12% per year during 1970-74. Israel has exceeded this growth rate in the past, and the forecast seems reasonable.

3. Non-Military Imports are projected to increase at an annual growth rate of almost 9%. This projection is consistent with a GNP growth rate of 8% and the overall estimate is realistic.

4. Capital Movements. Total capital imports are forecast to increase from slightly over \$700 million in 1969 to an average of \$845 million per year during 1970-74. Based on previous experience, this estimate appears optimistic. Net unilateral transfers (including gifts) are projected at \$512 million during the period, compared to \$521 million in the highly unusual circumstances following the war in 1967 when world Jewry donated in response to the emergency. In contrast, net unilateral transfers in 1969 were about \$475 million. Israeli forecasts of repayable capital imports are also optimistic. Israeli planners believe these capital import goals are attainable; however, additional financial assistance might be required if these estimates are not achieved.

5. Minimum Foreign Exchange Reserves are kept equal to the value of three months imports. Israel believes this level of reserves is needed to maintain international confidence. Approximately \$275 million (23%) of the total \$1.2 billion additional capital required is to increase foreign exchange reserves. While a three month reserve level is frequently used as a rule of thumb, the outlook for the balance of payments is more important than the actual level of reserves in maintaining international confidence.

6. Domestic Investment levels are not addressed specifically in the Israeli balance of payments forecast. If domestic investment can be maintained at the current levels (about 24% of GNP), Israel should be able to sustain an 8% annual growth rate.

7. Debt Service Payments reached a peak of \$175 million in 1969, but are expected to decline to \$113 million per year during 1970-73. In addition, foreign exchange earnings have been increasing, and as a result, the ratio of debt service payments to gross foreign

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exchange earnings has declined from 20% in the early 1960s to about 14% today. The World Bank projects a decline to 6% by 1973.

8. Military Imports are not specifically identified in the Israeli balance of payments forecast. However, the best indicator of Israeli military expenditures abroad is found in the "Government-Not Elsewhere Stated (N.E.S.)" account, the bulk of which consists of spending for military and military-related goods.

The total Government N.E.S. account represents a total of \$2.9 billion during 1970-75, about \$576 million per year. This is a considerable increase (almost 60%) in military expenditures from about \$370 million per year during 1967-69. Because of the large projected increase in military imports and its effect on foreign exchange requirements, the Government N.E.S. account represents one of the most important factors in the Israeli balance of payments forecast. The U.S. has little information on Israeli military import projections.

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-- Israeli requirements for U.S. financial assistance are directly affected by the level of military imports. For example, if Israeli Government N.E.S. requirements were reduced from the currently projected level of \$2.9 billion to \$2.0 billion, the need for more than normal levels of U.S. assistance would disappear altogether.

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Alternative Levels of Military Imports

-- Military Equipment. On the basis of analysis in previous sections, Israeli requirements for military equipment (aircraft, tanks, radars, etc.) during 1970-74 could vary from \$1 billion under the Current Strategy to \$200 million under Alternative Strategy #2 (Arab Response #1).

-- Capital Goods Imports. Enclosure VIII estimates the foreign exchange required to develop and operate a domestic production capability for key military items. The Israelis could produce substantial numbers of aircraft, patrol boats, tanks, and missiles during 1970-74 at a foreign exchange cost of \$500-700 million (including investment costs and production inputs). Any domestic production during 1970-74 (and it could be substantial at this level of investment) would provide military equipment in addition to that purchased from the U.S.

This analysis suggests that the \$2.9 billion of Government N.E.S. imports projected during 1970-74 significantly overstates the Israeli requirements. Assuming the U.S. decides to support the current Israeli military strategy (\$1 billion of military equipment imports) and an ambitious military production program (\$700 million), the Government N.E.S. import requirement would still be only about \$2 billion during 1970-74 (civilian government expenditures might be as high as \$300 million). Requirements would be \$400-500 million lower under the Alternative Military Strategies.

It would be feasible for Israel to support the projected military expenditures without U.S. assistance by absorbing a larger part of the cost in terms of a lower economic growth rate. Israel's growth rate is highly dependent on the level of non-military imports. At high levels of military imports, there would be inadequate foreign exchange to support the desired level of non-military imports and GNP growth rates would decline.

The table on Page 17 shows the approximate relationship between Israeli growth rates and military imports and the level of U.S. financial assistance required. The table shows U.S. financial assistance required under each of three alternative levels of Israeli military imports during 1970-74; the Current Israeli projection of \$2.9 billion, the maximum level explained by analysis in this paper of \$2.0 billion, and finally an intermediate level of \$2.5 billion. The table also shows two alternative Israeli growth rates; a full-employment 8% and a slightly lower 6% rate.

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--The current Israeli forecast (based on a projection of \$2.9 billion in military imports) would require \$900 million of U.S. assistance to maintain an 8% growth rate. About \$300 million is also requested to increase foreign exchange reserve levels (a total of \$1.2 billion). If Israel absorbs some of the cost in the form of a lower (6%) growth rate, the total U.S. assistance required would decline to \$500 million.

--If military imports can be reduced to \$2 billion during 1970-74, there would be no need for U.S. financial aid.

U.S. FINANCIAL ASSISTANCE REQUIRED
(\$ Millions)

	<u>Israeli GNP Growth Rate</u>	
	<u>8%</u>	<u>6%</u>
<u>Alternative Levels of Israeli Military Imports</u>		
\$2.9 billion	900	500
\$2.5 billion	500	100
\$2.0 billion	-	-

NOTE: These estimates are based on a simple econometric model and do not represent accurate projections. However, they represent a rough approximation of the U.S. financial aid required under alternative levels of military imports and growth rates.

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V. SUMMARY OF U. S. OPTIONS

A. Military Strategies. The analysis in this paper has focused on three possible military strategies which Israel might follow during 1970-1974 assuming no peace settlement:

1. The first is what we estimate to be the Current Israeli Strategy on the basis of the Israeli presentation of its equipment needs. In military terms, this strategy would ensure Israel's ability to absorb a surprise attack, defeat a coordinated attack by all Arab nations and provide convincing deterrence to Arab invasion. [U. S. intelligence estimates do not foresee this degree of Arab coordination in 1970-1974.]
2. The second is an intermediate alternative strategy developed to illustrate a slightly less ambitious but still superior Israeli force. This strategy would provide sufficient Israeli military capability to absorb and defeat a coordinated attack by its four Arab neighbors (Egypt, Jordan, Iraq, Syria) at least through 1974.
3. The third strategy is a lower alternative developed for illustrative purposes to suggest what might be required to fight a war in the same manner as Israel fought the 1967 war with some margin of safety. This would provide Israel the military capability to absorb and defeat an attack by Egypt followed by uncoordinated attacks by Syria, Jordan and Iraq. [In 1967, Israel defeated the first three fighting, concentrating forces against each as the need arose.]

B. Economic Analysis. Our analysis of Israel's balance of payments projections 1970-1974 -- the only basis Israel has presented to explain its economic assistance requests -- reveals unexplained foreign exchange requirements for almost \$1 billion (one third of the total). That amount plus about \$300 million for increasing foreign exchange reserves is just about equal to the \$1.2 billion foreign exchange "deficit" Israel has asked the U. S. to meet. It is necessary to under-

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stand one important point about the difference between the Israeli projections and the U.S. intelligence community's analysis of what it should cost to support Israel's military strategy: By U.S. analysis, Israel could achieve all known goals without any increase over present levels of financial assistance.

To be more concrete, the Israeli balance of payments projections during 1970-1974 would allow Israel to:

- Import the military equipment needed to meet the most ambitious military strategy outlined above.
- Import the capital goods, raw materials and component parts needed to develop domestic military production of jet aircraft, tanks, armored personnel carriers and naval patrol craft.
- Maintain civilian imports at a level that would support an 8% economic growth rate, the rate Israelis regard as optimum.
- Provide a large unexplained foreign exchange residual to be used by the Israelis, or a cushion for underestimates.

With regard to the large foreign exchange residual, U.S. analysis finds that approximately \$900 million to \$1 billion -- just about the amount which the Israelis have stated as Israel's foreign exchange deficit -- cannot be explained by estimated imports of military equipment and capital goods. Whereas the Israelis estimate \$2.9 billion in military imports during 1970-1974, U.S. estimates suggest that Israel could achieve all of its military equipment and capital import objectives with no more than \$2 billion, including enough civilian imports to support an 8% growth rate.

That means that -- unless the Israelis have an explanation for the large residual -- Israel could finance its military and civilian imports without U.S. assistance. Reducing its growth rate to, say 6%, would provide a margin of safety.

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- C. Domestic Production or Foreign Purchase? Israel plans to develop a domestic capability to produce major items of military equipment. By 1974 Israel could be producing equipment over and above that needed to support its most ambitious military strategy if it also acquires all military equipment now being requested. This suggests a choice for the U.S. of supplying finished equipment or providing the technology and capital goods required to develop Israeli domestic production capability, or a mix of these. We do not have any evidence that the Israeli military and economic planners are thinking of the economic trade-offs between these two courses.
- B. The Logic of Choice Among U.S. Options that follows from this analysis would seem to be as follows:
1. The first decision to be made is: What Israeli military strategy if any should the U.S. support? Enclosures IV and V show Israeli arms import requirements under each alternative strategy and Arab response. Specifically:
 - a. If the U.S. decides to support the Current Israeli Military Strategy as described above (para. A. 1. above), the U.S. should be prepared to provide Israel, 1970-1974, with:
 - 100 A-4 Skyhawk and as many as 75 F-4 Phantom aircraft (Israel has requested 100 and 25 respectively);
 - Additional tanks, Hawk missiles, artillery and helicopters.
 - b. If the U.S. decides to support the intermediate alternative Israeli strategy (A. 2. above), it should be prepared to provide:
 - Up to 45 more A-4 Skyhawks and 20-40 F-4 Phantoms;
 - Few other items of equipment except Hawk missiles.

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- c. If the U.S. decides to support the lower alternative (A. 3. above), we should be prepared to provide:

--Up to 20 A-4 Skyhawks and 20 F-4 Phantoms;

--No other major equipment, except perhaps some Hawks.

2. The second decision is: If the U.S. decides that support for a certain Israeli strategy is consistent with U.S. interests, what level of U.S. financial assistance is appropriate?

- a. By U.S. estimates, Israel should be able to meet the foreign exchange costs of any of the three strategies without any -- or at least without extraordinary -- U.S. aid. If, for political reasons, it were desirable to extend some assistance, this could be done as in the recent past in a range of \$100-160 million a year with a combination of military credit assistance, PL 480 and Export-Import Bank loans. Resumption of A. I. D. assistance or extraordinary measures (e.g. debt roll-over or assigning German offset loans to Israel) should not be necessary.

- b. Israeli estimates contain enough unexplained elements that further Israeli explanation should be requested before the U.S. resorted to extraordinary measures of financial assistance.

-- If the U.S. decided to support Israeli Military strategy and to accept Israeli economic projections, the U. S. would still have a choice between supporting an Israeli economic growth rate of 8% at a cost of \$900 million during 1970-1974 and supporting a 6% growth rate at a cost of \$500 million in 1970-1974 (or about the present aid level).

-- If the U.S. decided to support an intermediate Israeli military strategy and to accept Israeli economic projections, the U.S. could support an 8% growth rate at present aid levels (say \$100 million yearly 1970-1974) or virtually eliminate the need for aid at a 6% growth rate.

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-- The lower alternative military strategy would allow an 8% growth rate with no more than token financial assistance.

3. The third decision derives from Israel's strong desire to achieve relative self-sufficiency by expanding domestic production of sophisticated armaments. This Israeli effort will continue to be made even if the U.S. should decide to support Israel's force structure primarily through sales of end items, but Israel wants rights to produce U.S. weapons and systems if at all possible. The U.S. will face this question: If the U.S. decides to permit a wide range of Israeli access to technology and production rights rather than limiting this access in favor of placing primary emphasis on sales of military end items, what policy guidelines and means of enforcing them are necessary?

In the field of production rights and licensing, the U.S. in establishing precise guidelines, would have the option of drawing the line between any of these principal categories:

-- Routine Maintenance and Spares. This category would include production of spare parts for U.S. equipment currently in Israeli inventory, e.g. aircraft components, tank parts and missile components.

-- Present Military End-Items. Israel could be granted production rights to major military items -- or their components -- that are currently in Israeli inventory such as Hawk missiles, helicopters, M-48 tanks and electronic equipment.

-- New Weapons Systems. This category could include new technological weapons such as armed helicopters, fragmentation munitions, and sophisticated electronic equipment.

Similar guidelines could be established to govern the sales of military end items.

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SECRETENCLOSURE I.

NEAR EAST MILITARY FORCES
(As of November 1969)

	<u>Arab Nations</u>					
	<u>Iraq</u>	<u>Jordan</u>	<u>Syria</u>	<u>UAR</u>	<u>Total</u>	<u>Israel</u>
<u>Aircraft (Fighters)</u>						
High Performance	114	18	78	176	386	62
Medium Performance	74	18	66	137	295	162
Total	188	36	144	313	681	224
<u>Aircraft (Bombers)</u>						
Light	12	0	1	29	42	2
Medium	9	0	0	18	27	0
<u>Transports</u>	23	6	7	93	129	48
<u>Helicopters</u>	57	7	15	79	158	53
<u>Air Defense</u>						
SAM Missiles	0	0	0	500	500	280
SAM Launchers	0	0	0	250	250	48
AAA	825	446	1,396	840	3,507	534
<u>Tanks</u>						
Heavy	0	0	0	23	23	0
Medium	600	420	555	1,421	2,996	1,215
Light	30	0	16	56	102	0
<u>Artillery</u>						
100 mm & over	442	34	435	464	1,375	410
Up to 100 mm	520	165	90	1,025	1,800	606
<u>APCs</u>	975	250	550	700	2,475	2,000

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SECRETENCLOSURE II

ALTERNATIVE ISRAELI FORCE STRUCTURES
(December 1974)

	<u>Current</u> <u>Inventory</u>	<u>Current</u> <u>Israeli</u> <u>Strategy</u>	<u>Alternative #1</u>		<u>Alternative #2</u>	
			<u>Arab #1</u>	<u>Arab #2</u>	<u>Arab #1</u>	<u>Arab #2</u>
<u>Aircraft</u>						
High Performance	62	156	100	121	83	101
Medium Performance	<u>162</u>	<u>207</u>	<u>106</u>	<u>150</u>	<u>91</u>	<u>127</u>
Total	224	363	206	271	174	228
<u>Tanks</u>	1215	1300	1200	1300	1200	1200
<u>APCs</u>	2000	6000	2000	2000	2000	2000
<u>Artillery</u>	1016	1150	1000	1100	1000	1000
<u>Hawks</u>	280	420	280	420	280	420
<u>Helicopters</u>	53	110	53	53	53	53

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SECRETENCLOSURE III.ISRAELI AIRCRAFT REQUIREMENTS

	<u>High Performance Aircraft</u>	<u>Medium Performance Aircraft</u>	<u>Total Aircraft</u>
<u>Current Israeli Strategy</u>			
Current inventory	62	162	224
+ scheduled deliveries	34	30	64
- attrition	(15)	(45)	(60)
- obsolescence	-	(40) ^{a/}	(61)
+ additional purchases	75	100	175
End 1974 inventory	156	207	363

Alternative Strategy #1 (Arab #1)

Current inventory	62	162	224
+ scheduled deliveries	34	(30)	64
- attrition	(15)	(45)	(60)
- obsolescence	-	(40)	(40)
+ additional purchases	19	-	19
End 1974 inventory	100	106 ^{b/}	206 ^{b/}

Alternative Strategy #1 (Arab #2)

Current inventory	62	162	224
+ scheduled deliveries	34	30	64
- attrition	(15)	(45)	(60)
- obsolescence	-	(40)	(40)
+ additional purchases	40	43	83
End 1974 inventory	121	150	271

Alternative Strategy #2 (Arab #1)

Current inventory	62	162	224
+ scheduled deliveries	34	30	64
- attrition	(15)	(45)	(60)
- obsolescence	-	(40)	(40)
+ additional purchases	2	-	2
End 1974 inventory	83	91 ^{b/}	174 ^{b/}

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ENCLOSURE III, (continued)

	<u>High Performance Aircraft</u>	<u>Medium Performance Aircraft</u>	<u>Total Aircraft</u>
<u>Alternative Strategy #2 (Arab #2)</u>			
Current inventory	62	162	224
+scheduled deliveries	34	30	64
-attrition	(15)	(45)	(60)
-obsolescence	-	(40)	(40)
+additional purchases	20	20	40
End 1974 inventory	101	127	228

a/ Assumes that 20 of the 61 obsolete training aircraft will be lost to attrition before being retired; these 20 aircraft are included in the attrition estimate of 45 aircraft during 1970 - 1974.

b/ Totals will not add because of "negative" sales of medium performance aircraft.

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ALTERNATIVE ISRAELI AIRCRAFT REQUIREMENTS
(1970-1974)

	End 1974 <u>Inventory</u>	Arab/Israeli <u>Force Ratio</u>	<u>Foreign</u> Aircraft Requirements <u>Aircraft</u>	<u>\$Millions</u>
<u>Current Strategy (Arab #2)</u>				
High performance	156	3.9:1	75	335
Medium performance	<u>207</u>	<u>1.2:1</u>	<u>100</u>	<u>175</u>
Total	363	2.4:1	175	510
<u>Alternative Strategy #1 (Arab #1)</u>				
High performance	100	5.0:1	19	85
Medium performance	<u>106</u>	<u>1.7:1</u>	-	-
Total	206	3.3:1	19	85
<u>Alternative Strategy #1 (Arab #2)</u>				
High performance	121	5.0:1	40	178
Medium performance	<u>150</u>	<u>1.7:1</u>	<u>43</u>	<u>76</u>
Total	271	3.2:1	83	254
<u>Alternative Strategy #2 (Arab #1)</u>				
High performance	83	6.0:1	2	9
Medium performance	<u>91</u>	<u>2.0:1</u>	-	-
Total	174	3.9:1	2	9
<u>Alternative Strategy #2 (Arab #2)</u>				
High performance	101	6.0:1	20	89
Medium performance	<u>127</u>	<u>2.0:1</u>	<u>20</u>	<u>35</u>
Total	228	3.9:1	40	124

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ENCLOSURE V

TOTAL ISRAELI ARMS IMPORT REQUIREMENTS
(1970-1974)

	<u>Number</u>		<u>\$Millions</u>	
	<u>Arab #1</u>	<u>Arab #2</u>	<u>Arab #1</u>	<u>Arab #2</u>
<u>Current Israeli Strategy</u>				
Aircraft		175		510
Tanks		250		63
Personnel Carriers (APC)		6000		210
Hawk Missiles		160		47
Miscellaneous		-		<u>200</u>
Total				1030

Alternative Israeli Strategy #1

Aircraft	19	83	85	254
Tanks	100	100	25	25
Personnel Carriers	2000	2000	70	70
Hawk Missiles	-	160	-	47
Miscellaneous	NA	NA	<u>100</u>	<u>125</u>
Total			280	521

Alternative Israeli Strategy #2

Aircraft	2	40	9	124
Tanks	100	100	25	25
Personnel Carriers	2000	2000	70	70
Hawk Missiles	-	160	-	47
Miscellaneous	NA	NA	<u>100</u>	<u>125</u>
Total			204	391

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ENCLOSURE VI

US AID TO ISRAEL
FY 1965 - FY 1969

	<u>FY 65</u>	<u>FY 66</u>	<u>FY 67</u>	<u>FY 68</u>	<u>FY 69</u>
Development loans	20.0	9.5	0.0	0.2	0.0
P. L. 480	28.8	26.8	0.6	53.8	37.0
Eximbank long-term loans	<u>4.0</u>	<u>0.0</u>	<u>11.6</u>	<u>23.7</u>	<u>38.6</u>
Total economic	52.8	36.3	12.2	77.3	75.6
Military credit assistance	<u>13.5</u>	<u>92.0</u>	<u>7.0</u>	<u>25.0</u>	<u>85.0</u>
Total aid	66.3	128.3	19.2	102.3	160.6

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ISRAELI BALANCE OF PAYMENTS FORECAST
(\$ Millions)

	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>TOTAL</u>
Imports of						
Goods & Svcs.	2475	2675	2875	3100	3225	14,400
(Direct Gov't						
Imports)	(525)	(575)	(590)	(615)	(575)	(2880)
Exports of Goods						
& Services	<u>1500</u>	<u>1650</u>	<u>1825</u>	<u>2025</u>	<u>2250</u>	<u>9250</u>
Deficit on Cur-						
rent Account	975	1025	1050	1075	1025	5150
Capital Imports (Net)						
Unilateral Trans-						
fers	520	525	515	510	490	2560
Repayable	<u>330</u>	<u>350</u>	<u>360</u>	<u>315</u>	<u>310</u>	<u>1605</u>
Total Capital						
Imports	850	875	875	825	800	4225
Change in Reserves, Short Term						
Capital Movements,						
Errors & Omiss-						
ions	(125)	(150)	(175)	(250)	(225)	(925)
Additional Capital						
Imports Needed <u>1/200</u>		200	225	300	275	1200
Total Capital Imports						
Needed	1050	1075	1100	1125	1075	5425

1/ Assumes foreign exchange reserves are maintained at a level equal to the value of three months imports.

SOURCE: Israel's Foreign Exchange Position.

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ENCLOSURE VIII

TOTAL COSTS OF DEVELOPING MILITARY INDUSTRIES
IN ISRAEL
(US \$Million)

	<u>Assembly</u>	<u>Non- Assembly</u>
Aircraft	510	540
Patrol Boats	180	289
Tanks	25	125
Missiles	100	100
Total	815	1054
Foreign Exchange Component	70%	65%
Foreign Exchange Costs	570	685

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